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SUBJECT: UNLOCKING RUSSIA'S HOUSING MARKET POTENTIAL: VIEWS
FROM AN INTERNATIONAL FIRM

Summary

¶1. (SBU) Improving Russia's housing sector is often mentioned as one of the new government's highest economic priorities. To better understand the issues at play, we met with a series of experts in April and May. Sergey Riabokobylko, Senior Executive Director, and Denis Sokolov, Head of Research at Cushman and Wakefield) an international real estate services company active in Russia) told us the sector has great growth potential, but that this potential is blocked by both structural and psychological factors and that unlocking it will require government action. End Summary.

Russia's Stagnant Housing Sector

¶2. (SBU) Sokolov and Riabokobylko said their company focuses on commercial real estate in Russia, where they directly manage properties. However, they said Cushman and Wakefield is also involved in residential projects in Russia as well, where prices have been rising rapidly. The company usually serves as a "catalyst" for projects by linking up developers with financing and then advising on marketing strategies. According to the two executives, the sector has great growth potential but realizing that potential will be a long process given the relatively undeveloped state of Russia's residential real estate market.

¶3. (SBU) Riabokobylko said five years ago Russia's mortgage market was non-existent. Last year it grew from 1.3 to 2.3 percent of GDP. Although a significant increase, mortgage penetration remains low compared to Poland, Hungary and the Czech Republic where mortgages have already reached 10-15 percent of GDP. Sokolov said another telling statistic is the level of indebtedness to equity. In Western countries this approaches and in some cases even exceeds 100 percent. In Russia, the corresponding statistic is 5 percent. Sokolov stressed that these statistics were evidence of the sector's lack of maturity but also of its enormous potential as a source of long term financing in Russia. If the economy discovers a way to unlock the enormous wealth tied up in Russia's housing, it could have global financial implications.

¶4. (SBU) Sokolov said there are serious structural obstacles to growing the residential housing sector. 85 percent of Russians live in housing that they and their families received free from the government at the time of the Soviet Union's break up. This housing is extremely difficult to

price. A 1,000 square foot apartment in central Moscow, for instance, on paper might be worth over a million dollars, but there are relatively few potential buyers. Since it is difficult to sell, it is difficult to move into newer, better housing.

15. (SBU) Moreover, Sokolov said, much of this housing is of poor quality and since Russians lack a sophisticated understanding of housing as a financial asset, they generally spend little time or money maintaining or renovating their homes. The government has reported that two-thirds of all housing is in need of repair and 3.2 percent is officially uninhabitable. Finally, he noted that although long-term mortgages are readily available, they are prime mortgages with prevailing interest rates that average 12.5 percent, too expensive for most Russians.

16. (SBU) Sokolov said the obstacles are also psychological. Russians have yet to overcome their lack of confidence in the future and in saving. As a result, Muscovites spend on average 130 percent of their income, relying on rising real incomes to finance growing consumer debt but making little provision for the future, especially with respect to upgrading their housing, which is simply unaffordable for the average Russian.

Unlocking the Sector

17. (SBU) Sokolov said unlocking the housing sector should be

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a priority of the new government. He argued that the psychological impediments would dissipate over time, especially since younger Russians were much more sophisticated when it came to taking on long-term debt, but structural obstacles needed to be addressed head-on. Although market solutions were preferable, the State was responsible for a number of these obstacles, and as such, had an essential role in speeding Russia's development of a modern, market driven housing sector. The great deal of pent up demand among Russians of all economic classes for better housing would only increase as the economy continued to grow and expand and as income levels continued to rise.

18. (SBU) Sokolov said the key for the government would be encouraging a supply response to meet this rising demand, and in particular, taking steps to address the structural obstacles. For instance, the lack of land near city centers zoned for residential use was a major cause of inadequate supply. Much of this land is still zoned for agricultural use and the shortage is driving up the remaining urban land prices, contributing to the explosive growth in real estate prices. Moreover, given the high cost of the land, developers are more likely to build luxury apartment buildings, which are easier to market and provide higher returns than housing that would appeal to the middle classes.

19. (SBU) Sokolov said the National Priority Project (NPP) in housing forced the GOR to allocate some land for residential development. However, this was done through an auction process that Sokolov described as "not exactly transparent." The prime, scarce plots that the GOR decided to auction off were acquired by developers with insider connections, who then built expensive homes for Russia's elite. Sokolov said the government should make still more land available to developers, but through a much improved auction process.

110. (SBU) Sokolov said the GOR also needed to aid the sector's development by improving the social services and transportation networks in suburban and exurban areas. This would lower development costs and create incentives for building more affordable housing. Finally, Russia was still over centralized and the government could provide incentives

to people to relocate from Moscow, reducing housing pressure in the capital and spurring economic development, including the construction of better housing, in the regions.

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